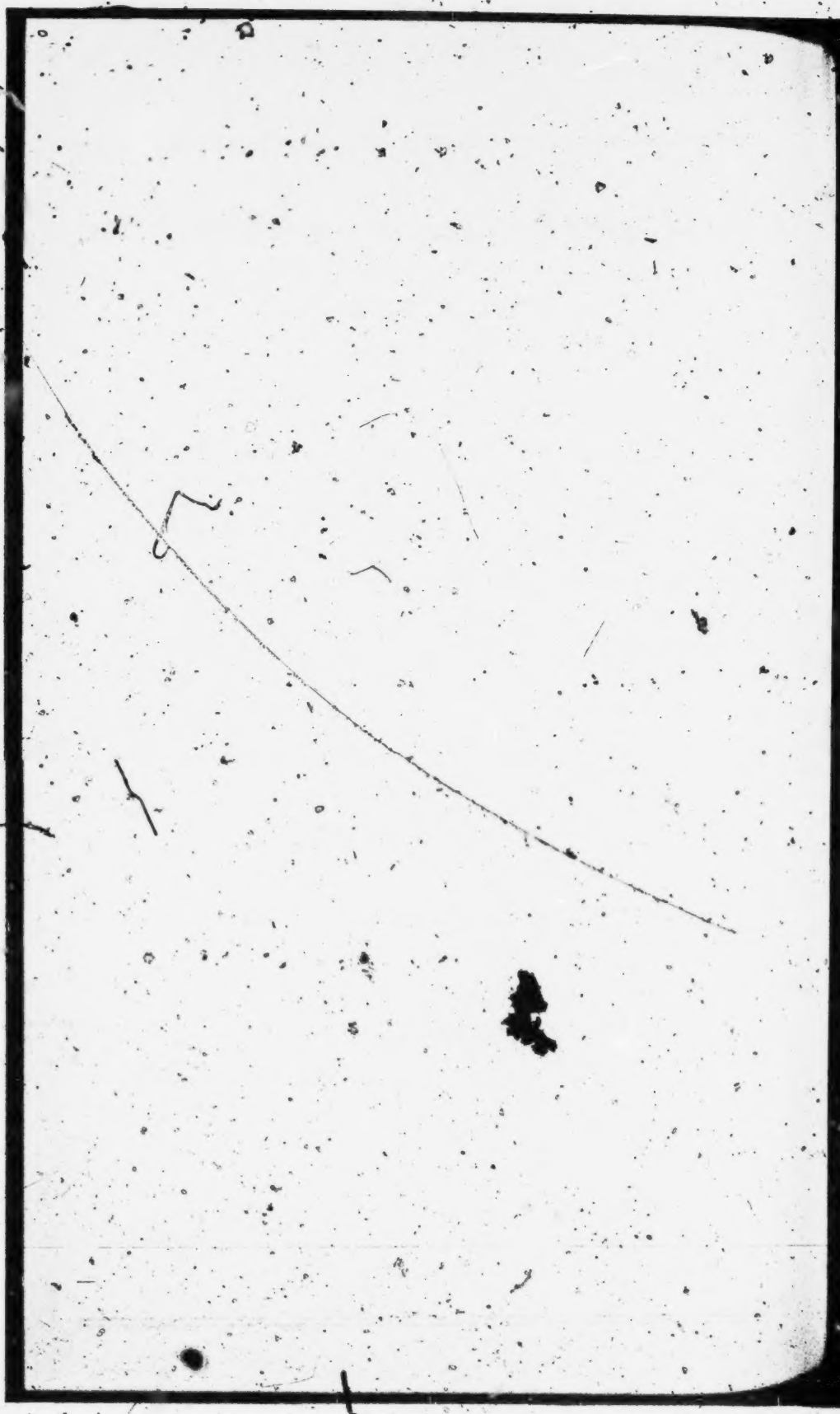

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In the Supreme Court of the United States

OCTOBER TERM, 1931.

No. 426.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CHARLES P. LEININGER.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

QUESTION PRESENTED.

The sole issue may, we believe, be fairly stated as follows:

> "A, resident and citizen of Ohio, being in partnership with B, each owning a half interest, entered into an agreement with his wife W, based upon a legally sufficient consideration, whereby W became 'a full equal partner' with A in his 'interest' in the partnership; 'the fact of the transfer was communicated' to B. The business continued without objection or interruption. Under these circumstances is A to be taxed upon all of the subsequent profits attributable to the one-half interest originally owned by him, or may A and W each return and pay tax upon one-half thereof?"

STATUTES INVOLVED.

These are set forth in the Appendix of Petitioner's Brief, pp. 29-32.

STATEMENT.

The peculiar and special facts of the case are set forth in the findings of the United States Board of Tax Appeals, which we summarize as follows:

1. "In 1898 a partnership known as Eagle Laundry Company was" formed by respondent "and one M. G. Monaghan, each owning a one-half interest." (R. 16)

2. "In 1904 Monaghan died and his wife, Mary T. Monaghan, succeeded to his interest in the firm and on the books of the company." (R. 16)

3. "In 1920 Mary T. Monaghan transferred by bill of sale her interest to her children. The entire Monaghan interest was thereafter carried on the books in the name of Marcus A. Monaghan." (R. 16) * * * "Each of the three children of Mary T. Monaghan, however, returned a proportionate part of the income for taxation." (R. 16)

4. "During the latter part of 1920 a written agreement, confirmatory of a pre-existing oral agreement, was entered into between petitioner[1] and his wife, wherein it was acknowledged that *petitioner's wife had been and was a full equal partner* with him *in the interest* in the Eagle Laundry Company, entitled to share equally in the profits and obligated to bear equally any losses. The contract was effective from the beginning of 1920." (R. 17)

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[1] "Petitioner" before the United States Board of Tax Appeal is the Respondent herein.

Note: All italics throughout this brief are supplied.

Note: The United States Board of Tax Appeals is sometimes hereinafter referred to as the "Board".

5. "The fact of this transfer was communicated to Marcus A. Monaghan, who represented the owners of the other one-half interest in the Eagle Laundry Company." (R. 17)

6. "The Leininger interest always stood in the name of C. P. Leininger on the partnership books but Mrs. C. P. Leininger returned one-half of the profits of the Leininger interest for taxation." (R. 17)

7. "Petitioner[1] and his wife maintained prior to and throughout the period here involved a joint bank account on which each could draw unrestrictedly. The profits received from the partnership were deposited in this account by Leininger, no checks on the partnership being drawn to the wife." (R. 17)

SUMMARY OF ARGUMENT.

The trial court, namely the United States Board of Tax Appeals, having made findings of fact, those findings must here be given the same effect as a jury's verdict. The Board found as a fact that the "interest" of the respondent in the partnership was, with the knowledge of the respondent's partners, owned in equal shares by himself and his wife. It follows as a necessary conclusion of law that the profits of the partnership allocable to the wife's "interest" in the respondent's "interest" were taxable income to her and not to him. The 1920 agreement referred to in the Board's findings assigned to her not merely future earnings but rather a portion of the corpus from which those earnings were to flow. As said by the Circuit Court of Appeals in its opinion (R. 26):

> "We cannot regard this contract as a mere assignment of an interest in future profits 'if, when and as' received. It creates mutual rights and liabilities; it is irrevocable; it creates, at least as between the parties, a vested interest in a property right; and the specified profits and losses were hers, not his."

---

[1] See footnote, page 2.

The contract between respondent and his wife was upon a legally sufficient consideration; it was a lawful and binding agreement. The parties were competent to make such contract under the law of Ohio. The agreement, having been entered into in good faith, must be recognized and sustained even though the result may be to lessen the aggregate income tax liability of husband and wife. The benefit so derived, if any, was procured by the respondent at the cost of a conveyance (found by the Board as a fact) to another of a one-half interest in his interest in the partnership. That conveyance, *concluded and irrevocable,* even though made to his wife, might be to his decided disadvantage in the future, for it gave the wife with the knowledge of his partners full right of ownership, whether legal or equitable is immaterial, in an existing corpus; such ownership importing *inter alia* ownership in her own right of income consequent upon her share in the corpus. They made the agreement for better or for worse and should be permitted to harvest its advantages while being held to its burdens.

We shall endeavor to make clear that the judgment of the Court below upon the facts as found, is correct—this case, under its own special facts, being easily distinguishable from the authorities upon which the Government relies—the latter being cases in which the assignment amounted to no more than an attempt to transfer future income as such with no concurrent transfer *in praesenti* of the corpus producing such income. The applicable sections of the Revenue Acts of 1918 and 1921, the decisions of the Board of Tax Appeals, those of the several Circuit Courts of Appeal and of this Court, fully recognize the distinction for which we contend. The rule which runs through all the cases, as we shall show, was, perhaps, well stated by the Board in *J. V. Leydig v. Commissioner,* 15 B. T. A. 124, 132 (affirmed 43 Fed. (2d) 494 C. C. A. 10 and ac-

quiesced in by the Commissioner of Internal Revenue in C. B. VIII-2 page 31) as follows:

> "The cases * * * are singularly free from conflict as to the principle governing the issue raised. From them we conceive the rule to be that income *per se* cannot be assigned to relieve the assignor of the tax levy, but, where the thing assigned was a property right, real or personal, productive of income, income thereafter arising from such property is income to the assignee by virtue of his ownership."

We shall present our argument and citations under five headnotes, as follows:

I. The United States Board of Tax Appeals found as a fact that respondent's wife owned the corpus which produced the income here in issue: the findings of fact made by the Board are, for the purposes of this case, conclusive.

II. Income is taxable only to the equitable owner of the corpus which produces such income.

III. Section 218(a) of the Revenue Acts of 1918 and 1921 merely prescribes that partnership income is taxable directly to its owners whether distributed or or not. The word "partner" is used as synonymous with "owner". The rule heretofore discussed applies where the assigned corpus is part of a partnership interest.

IV. The construction of section 218(a) of the Revenue Acts of 1918 and 1921 urged by petitioner is unconstitutional.

V. The cases relied upon by the commissioner are based on facts readily distinguishable from those of the instant case: they apply to attempted assignments of future income only (as distinguished from an assignment of corpus as herein) or to revocable grants (as distinguished from an irrevocable assignment of corpus as found herein).

ARGUMENT.

I.

THE UNITED STATES BOARD OF TAX APPEALS FOUND AS A FACT THAT RESPONDENT'S WIFE OWNED THE CORPUS WHICH PRODUCED THE INCOME HERE IN ISSUE: THE FINDINGS OF FACT MADE BY THE BOARD ARE, FOR THE PURPOSES OF THIS CASE, CONCLUSIVE.

It should be observed that the evidence before the Board is not included in the record; upon the evidence the Board made special findings (R. 16, 17). These must be given "the same effect as the verdict of a jury" (28 U. S. C. A. 773, U. S. Rev. St. section 649) and, in the absence of a bill of exceptions containing the evidence, are conclusive. (*Cyc. of Federal Procedure*—Longsdorf—Volume VI, page 643). This rule is applicable to reviews of decisions of the Board of Tax Appeals (*Phillips v. Commissioner*, 283 U. S. 589, 600): as said by the Circuit Court of Appeals (6th) in *Cogar v. Commissioner*, 44 Fed. (2d) 554, 556

> "Upon this point the Board made a specific finding * * * none of the evidence before the Board of Tax Appeals is returned with the record and we cannot therefore review the question";

and by the Court of Appeals of the District of Columbia in *Evergreen Cemetery Association v. Burnet*, 45 Fed. (2d) 667

> "The record does not set out any of the testimony heard by the Board; the findings of fact reported by the Board are therefore accepted as conclusive";

see also *United States v. Copper Queen Mining Co.*, 185 U. S. 495, 497.

It should be noted from the Board's findings (R. 17) that, although on the partnership books the "Leininger interest" stood in respondent's name, his wife, "had been

and was a full equal partner with him in the interest"; also that the Monaghan interest in the partnership was "carried on the books in the name of Marcus A. Monaghan" (R. 16, 17) although *owned* by the three children of Mary T. Monaghan: in other words, the books disclosed as to both sides of the partnership a record ownership differing from the actual and equitable ownership; also "the fact" of the "transfer" of one-half of the Leininger interest to his wife "was communicated to Marcus A. Monaghan, who represented the owners of the other one-half interest." (R. 17) That the Board intended these findings to imply an ownership *in praesenti* of income-producing corpus rather than merely an assignment of future income is indicated by the inclusion in the Board's syllabus of the following language (19 B. T. A. 621): "Notwithstanding a contract beween himself and wife that they were partners in all of his property * * *." The petitioner in his brief (p. 4) concedes: "The evidence is not reported in the record, and the findings of the Board are not challenged."

The agreement found by the Board conveyed to respondent's wife a half ownership in a producing corpus. There is no restriction in Ohio against the full right of husband and wife to contract with each other as the Board found they had. (*Bank v. Rice*, 22 O. C. C. 183, 198; *Dillingham v. Dillingham*, 28 O. C. A. 49, 60, 61; *Gould v. Cooper*, 15 O. A. R. 223; *Dredge and Dock Co. v. Smith*, 16 O. C. C. N. S. 344, affirmed 84 O. S. 482; *Higbee Co. v. Crum*, 27 O. A. R. 107; *Shafer v. Shafer*, 30 O. A. R. 298, 299.)

Section 7999 General Code of Ohio provides:

> "A husband or wife may enter into any engagement or transaction with the other, or with any other person, which either might if unmarried;"

Bearing in mind the knowledge of each of the record partners as to the subdivision of the interest of the other (R. 17) the conclusion is inescapable that Mrs. Leininger became, by virtue of the agreement as found, either a member of the original partnership (*Rosenstiel v. Gray*, 112 Ill. 282; *Smith-Powers Logging Co. et al. v. Bernitt, et al.*, 237 Fed. 570, 572) or, at least, the equitable half owner of the Leininger interest (*Nirdlinger v. Bernheimer*, 133 N. Y. 45, 53; *Nixon and Chatfield v. Nash, et al.*, 12 O. S. 647, 649; *Parish v. Bainum et al.*, 306 Ill. 618). As said in *Sherk v. First National Bank* (Texas), 152 S. W. 832: "A partner's 'interest' is property which can be sold and transferred" and the assignee becomes "a tenant in common with the co-partner" (*Stokes, et al. v. Stevens, et al.*, 40 Cal. 391, 394); or, as held in *Van Brocklen v. Smeallie*, 140 N. Y. 70, "plaintiff's partnership interest was personal property, and the title passed at once on the execution of the agreement."

We submit that a serious fallacy runs through the petitioner's brief in that it ignores the express findings of fact made by the Board. We refer particularly to the findings:

> (1) That the agreement between respondent and his wife recognized her as "a full equal partner with him in the interest in The Eagle Laundry Company" (R. 17);
>
> (2) That "the fact of this transfer was communicated" to the representative of the other partners (R. 17).

Notwithstanding these findings the petitioner argues that respondent's wife, by the agreement, acquired only a right to receive a share of profits when and as earned, that she became neither a partner in the laundry company nor the owner of the corpus which produced the income here in

question. We may summarize and briefly answer the arguments so made as follows:

(1) That the "other partners" did not *expressly* consent. The petitioner in his brief (p. 6) refers to the "other partners" thereby conceding that the Monaghan children had all become partners by virtue of the bill of sale referred to at R. 16. "The fact" of the transfer by respondent to his wife was communicated to the representative of "the owners of the other half interest" (R. 17). And, as the petitioner admits in his brief (p. 27), "the business of the laundry company continued thereafter as it had before." Obviously there was acquiescence by the "other partners" to the entry of Mrs. Leininger into the partnership. Petitioner argues that the injection of a new member operates as a dissolution. But laymen do not give thought to such legal niceties; and, in any event, if there was a technical dissolution of the old, there occurred instantly the formation of a new partnership with Mrs. Leininger as a member, in the same manner as the children of Mrs. Monaghan had become members by virtue of the bill of sale (R. 16). The case, we submit, is on all fours with *Smith-Powers Logging Company et al. v. Bernitt et al.*, 237 Fed. 570, 572.

(2) Next the Petitioner argues that the absence of Mrs. Leininger's name in the books and tax returns of the partnership precludes her being treated as a partner. But tax liability is not to be determined by "mere book entries"; it must stand upon the solid ground of intent and fact, where such intent and fact can be found, as they were specifically found by the Board in the instant case. As was said in *Eaton v. English and Mersick*, 7 Fed. (2) 54:

> "We are not particularly concerned about the entries which were made in the books of the company. We may repeat what we said in *Douglas v. Edwards*, 298 Fed. 229, 234, that it is well to realize that, in this case, the rights of the parties can neither be

established nor impaired by the bookkeeping methods employed or by the names given to the various items."

As this Court said in *Doyle v. Mitchell*, 247 U. S. 179, 187, the facts and not the book entries govern. (See also *Isbell Porter v. Commissioner*, 40 Fed. (2) 432; *A. Kreamer Inc. v. U. S.*, 66 Ct. Cl. 308; *Henry Myer Thread Mfg. Co. v. Commissioner*, 2 B. T. A. 665, 666; *Appeal of Cleveland Woolen Mills*, 8 B. T. A. 49.)

(3) The petitioner further urges that Mrs. Leininger "did not possess other powers which ordinarily or necessarily inhere in a partner." But, we may answer, there are various classes of partners; Mrs. Leininger may well have been a secret, a silent or a dormant partner (47 *C. J.* 647, 713) and yet a partner as far as this cause is concerned.

(4) Equally without force is the suggestion that the respondent's wife contributed no capital to the partnership. Contribution of either capital or services is not essential (20 *R. C. L.* 834). But if a contribution to capital were necessary, it must be conceded by petitioner that from 1920, at least, Mrs. Leininger was an equal owner of the respondent's investment and the leaving of that interest in the business constituted her capital contribution thereto.

(5) The argument that there was a failure to file a certificate setting forth Mrs. Leininger's interest in the partnership, as required by Ohio General Code Sections 8099, 8102 is devoid of merit. Those sections do not have the effect apparently assumed by counsel. They are followed by Section 8104 which fixes the penalty for noncompliance in the form of a merely temporary stay to actions on contracts brought by the partnership; the sections in question do not in any degree affect the validity of a partnership or the rights of partners. (47 *C. J.* 746; *Commissioner v. Barnes' Estate*, 30 F. (2) 289.)

(6) Finally, the argument is made, "Even if this Court should hold that taxability of the partnership income

always follows the ownership of the income-producing corpus the respondent must fail. For here that corpus consisted of the physical assets and intangible assets of the company. To the extent that these elements of a going business could be owned, they belonged to the partners of the Eagle Laundry Company as joint owners."

We respectfully submit that the income-producing corpus, so far as the Leininger income was concerned, was not the physical assets as such of the partnership, for the title thereto was in the partnership and not in the partners (see *infra*), but rather the partnership interest of the respondent, which partnership interest was transferable as a matter of law and was (as to one moiety) transferred as a matter of fact by respondent to his wife. There is no thought on our part that the mere right to share profits constitutes one a partner or that a mere transfer of a right to receive future profits relieves the assignor of the tax burden. But Mrs. Leininger became not merely a sharer of profits and losses; by the very terms of the Board's findings (R. 17) she was *"a full equal partner with him in the interest in the Eagle Laundry Company."* It is true that the finding recites that she was "entitled to share equally in the profits and obligated to bear equally any losses" but the use of that clause does not detract from the import of the finding of "full equal" partnership. The maxim *"Expressio eorum quae tacite insunt nihil operatur"* applies. (See *Broom "Legal Maxims"*, 3rd ed. p. 424.) Clearly respondent's wife was constituted the owner not alone of future profits but, over and beyond that, the owner of something more fundamental, namely of an interest in the business itself. To make it unequivocal and emphatic the Board used the expression, as had the contract, "full equal partner."

> "Although no partner owns absolutely any part of the property, he has his own interest in the whole; which interest we have defined as an ownership of the

whole, subject to the ownership of the other partners. And the question has repeatedly arisen, whether he can sell and transfer this interest. The answer, in general, is in the affirmative." *Parsons on Partnership* (4th ed. Section 112).

"Thus it may be stated that each member of the firm has an interest in the firm property which is hardly more than a chose in action, an interest somewhat uncertain in its value, subject to levy * * * to his mortgage * * * and to sale by him either to a copartner or a third person * * * it must be considered property." *Rowley "Modern Law of Partnership,"* Sections 291, 292.

"It is immaterial what effect the assignment by C of his interest in the property belonging to the firm of C and H had upon the partnership, or whether the assignee and H constituted a new partnership. The assignment, at least, operated to vest C's interest in the assignee, and to make him, jointly with the other partner, the owner of the assets which had belonged to the partnership." *Keith & Son v. Ham,* 89 Ala. 590, 593.

See also *Stokes et al. v. Stevens,* 40 Cal. 391.

The transferee of a partner's interest gets not specific assets as such because his grantor had no such title to convey: "the property or effects of a partnership belong to the firm and not to the partners"; but the transferee acquires exactly what the grantor had to convey, namely "a partnership interest." (*Bank v. Carrollton Railroad,* 78 U. S. 624, 628, 629.)

We submit that the entire substructure of petitioner's argument falls and the cases relied upon become inapplicable when we apply to the findings of fact in the instant case the words of the court in *Rosenstiel v. Gray,* 112 Ill. 282 cited with approval by the Circuit Court of Appeals (9th) in *Smith-Powers v. Bernitt* (*supra*). At p. 291 the court said:

"From the length of time which elapsed * * * with no objection appearing * * * there would be ground of inference of an implied acquiescence * * * in R's becoming a member of the firm. *But, supposing R was not a partner* with the consent of Rosenstiel, *he was a joint owner* with G, S and Rosenstiel at the time Rosenstiel went out of the firm * * *."

And so, we contend, there is no warrant for the assumption by the petitioner in this case that the agreement between respondent and his wife amounted only to an attempted transfer of future profits. The findings of fact vitiate such assumption. Whether the agreement, coupled with the knowledge and acquiescence (as found by the Board) of the other partners, was tantamount to the admission of the respondent's wife into the partnership or merely constituted her a joint owner with him of his interest therein, the Board's findings compel the legal conclusion that, by virtue of the agreement, during the years involved, the respondent's wife was the owner *in praesenti* of a fixed, definite property corpus, and that corpus was the source of the income here involved. The supposed difficulty conjured up by the petitioner at page 10 of his brief is no difficulty at all; the wife would stand precisely in the shoes of the husband as to the interest acquired by her, taxable under the same conditions, at the same time and to the same extent as he.

II.

INCOME IS TAXABLE ONLY TO THE EQUITABLE OWNER OF THE CORPUS WHICH PRODUCES SUCH INCOME.

As we shall see, the cases upon which the Government relies involve only an assignment or attempted assignment of income *in futuro*. Such cases have no application to the facts of the instant case as found by the Board. For example, two cases most strongly urged by the Government

as in conflict with the decision of the Circuit Court of Appeals herein, namely *Mitchel v. Bowers,* 15 Fed. (2d) 287 and *Bing v. Bowers,* 26 Fed. (2d) 1017, distinctly recognize the correctness of our position under the facts of the instant case.

The syllabus of *Mitchel v. Bowers* (*supra*) indicates that the Court's judgment would have been for the taxpayer had his wife acquired by the operative agreement a "present interest equitable or legal." And in *Bing v. Bowers* (*supra*) the Court of Appeals, Second Circuit, affirmed "upon the opinion of Mack, *J.*, below" *Bing v. Bowers,* 22 Fed. (2d) 450, wherein the distinction between a mere assignment of future income and the transfer of an interest in income-producing corpus is set forth at great length and with compelling logic. The propositions of the syllabus of *Bing v. Bowers* indicate conclusively that the judgment below *does not conflict* with either *Mitchel v. Bowers* or *Bing v. Bowers* (*supra*):

> 1. "A gift or assignment to members of one's family is proper, even though it be for the purpose of cutting down total family income tax contribution to the government, as long as the gift or assignment is actual or bona fide."
>
> 5. "Where instrument executed by son assigned to mother certain so-called annuities, payable out of income from interest in property, *did not pass his interest* or create a rent charge, *or any ownership pro tanto* of his interest in property, and grantee was at best only entitled to net income or to stipulated sums to be paid therefrom, and grantor maintained right of control, the income received therefrom was taxable to grantor, notwithstanding the instrument was *in form* proper for a grant of interest in real estate."
>
> 6. "Where assignor of future income from property *remains the owner* thereof, the income therefrom is taxable to him as fully as when he grants it as a gift in advance of his receipt, as it clearly is, despite a gift thereof immediately after its receipt."

Indeed the Court of Appeals for the Second Circuit, which had decided the cases of *Mitchel v. Bowers, Bing v. Bowers* and other cases cited herein by the Government, itself clearly defined the intended scope and limitations of these cases by holding, in *Commissioner v. Marshall Field,* 42 Fed. (2d) 820, 822:

> "These were, however, all cases in which, though the instrument affected to convey an existing interest in property, there was none at the time which the law recognized. We do not understand that where there are such, they may not be assigned like other property, or that, when they have been, the income is still taxable to the assignor."

The United States Board of Tax Appeals, as we have already seen in our reference to the *Leydig* case (*supra*), has recognized and followed the rule for which we contend. The difficulty the Board has had, as evidenced by its decisions, has been, not as to the validity of the rule, but rather as to the legal implications of the facts of each case as presented. For example, in *Copland v. Commissioner,* 15 B. T. A. 238, there was involved the question as to whether the Petitioner had conveyed to his wife his interest in a joint venture or merely his share of the profits thereof when and if earned. The Board held against the Petitioner on the facts, but said, at page 240:

> "If the asset giving rise to the income was assigned, then the income is not taxable to the petitioner. But if income or profits only were assigned, they become taxable to the petitioner regardless of their assignment or transfer to the petitioner's wife."

The Circuit Court of Appeals (7th), on review, reversed (41 Fed. (2d) 501) and said at page 504:

> "Appellee has called our attention to *Rosenwald v. Commissioner,* 33 F. (2) 423 and *Bing v. Bowers,* 22 F. (2) 450, as determinative of the question of transferring without consideration a thing not in existence.

In these cases the donor never parted with possession and control of the corpus; in the instant case he did, and the transfer included more than future profits—it included not only the right to draw the profits, but *the very thing which would produce them.* • • •

"It is further contended by appellee that the future profits of the venture were not assignable, for the reason that they were not then in existence. The instrument in controversy not only assigns to his wife all of petitioner's right, title and interest in and to any profits, issues and income that may arise thereunder, but also all of his right, title and interest in and to the syndicate agreement. *This assignment includes more than future income—it includes the thing that produces the income, and the right to receive the income.*"

In *Parshall v. Commissioner,* 7 B. T. A. 318, the Board, after stating the Commissioner's reliance upon *Mitchel v. Bowers* (*supra*) said, at page 321:

"The question involved in that case was very substantially different from the question at issue in the instant case. In the *Mitchel* case the husband was a partner in a firm. He made a contract with his wife by which he agreed for a valuable consideration to transfer and assign to her, until future notice, one-half of his share of the profits of that partnership. *There was no attempt on his part to convey to his wife his interest in the partnership or any part thereof. She received no vested right* or interest in the partnership as such. All she received was a right to demand from him one-half of the profits he received from that business."

And, in a case almost identical with the case at Bar, namely *Thomas v. Commissioner,* 8 B. T. A. 118, the Board held, as syllabus:

"A member of a partnership is not individually taxable on so much of the partnership income as is *attributable to an interest in his interest* in the part-

nership which, at the date of the formation of the partnership, he had sold to a third person although such purchaser was not a member of the partnership."

And in its opinion, at page 119, the Board said:

"The transaction between petitioner and his daughter * * * was a sale of capital assets. * * * The daughter purchased not an interest in profits alone, but a one-half interest in petitioner's one-half interest in R. P. Drilling Company. * * * As between her and petitioner there existed *a partnership not only as to profits but also as to corpus.* If petitioner had defaulted on his contract, the daughter would have been entitled to bring an action against him and in that action to have made Parks a party for the purpose of an accounting. See *Nirdlinger v. Bernheimer,* 133 N. Y. 45. Petitioner held his daughter's interest in trust for her. Cf. *Barnes v. Alexander,* 232 U. S. 117. * * *.

"This income was, as to her, taxable income and as such has been properly returned and taxed. This income which was taxable to the daughter was not, under the facts of this case, at the same time taxable also to the petitioner. He held it as trustee, and since it was at once distributable, he had the right under section 219 of the Revenue Act of 1918 to deduct it from the gross income of the trust.

"This conclusion is not in conflict with the decisions in *Appeal of S. V. Woods,* 5 B. T. A. 413; *Appeal of Fred W. Warner,* 5 B. T. A. 963; *Appeal of Ormsby McKnight Mitchel,* 1 B. T. A. 143; and *Mitchel v. Bowers,* 15 Fed. (2) 287. In each of these cases the transaction involved was the transfer to another of income which arose from the property of the transferor and in each case it was held that such transfer did not lessen the taxable income of the owner of the property from which the income was derived. In this case petitioner did not assign income produced or to be produced from his property. He sold an interest in his interest in the Drilling Company. It was his daughter's interest in the corpus which produced her share of the

income. The *Mitchel* case contained another important element which is not present in this case. The contract between Mitchel and his wife was revocable by either party."

And in *Hallahan v. Commissioner*, 14 B. T. A. 584, involving income arising upon a partnership interest standing on the books in the name of one but equitably owned by others, the Board said at page 596:

> "This petitioner under the rule stated, is, as to the interests of his mother and brother in the partnership interest passing to him on his father's death, merely a trustee and any profits distributed to him are received in trust to the extent of their interests, just as any other income of trust property is received. He has no beneficial interest in them.
>
> "Can it be said, *merely because they are profits upon a partnership interest standing in petitioner's name,* that they are distributable to him and must be included in the net personal income upon which he individually must pay a tax? We have had substantially this same situation presented to us before and have drawn definitely *the distinction* between those cases of which *Ormsby McKnight Mitchel, supra,* is an example, where the beneficial interest in the *income alone* has been assigned by the party owning the corpus, and those in which the income is produced by property belonging to two jointly, *although the ownership of only one was disclosed* and the total income actually collected by that party, who then accounted to his undisclosed co-partner in interest for the latter's share. In these cases we have held the individual receiving the total income *taxable only on the portion in which he individually had the beneficial interest,* the portion paid his associate being merely received by him in trust for such party. Citing *C. R. Thomas,* 8 B. T. A. 118; *W. W. Parshall,* 7 B. T. A. 318; *Ralph L. Hinckley,* 6 B. T. A. 312; *H. P. Kelly,* 9 B. T. A. 832."

It seems obvious from the foregoing that the Board's decision herein (which the Circuit Court of Appeals

reversed) was in direct conflict with its decisions in other cases upon comparable facts; that the reversal of the Board by the unanimous decision of the Circuit Court of Appeals was proper and, upon the facts, there is no conflict between that decision and the holding of the Court of Appeals in the Second Circuit in *Mitchel v. Bowers* and other cases (*supra*).

III.

SECTION 218(a) OF THE REVENUE ACTS OF 1918 AND 1921 MERELY PRESCRIBES THAT PARTNERSHIP INCOME IS TAXABLE DIRECTLY TO ITS OWNERS WHETHER DISTRIBUTED OR NOT. THE WORD "PARTNER" IS USED AS SYNONYMOUS WITH "OWNER". THE RULE HERETOFORE DISCUSSED APPLIES WHERE THE ASSIGNED CORPUS IS PART OF A PARTNERSHIP INTEREST.

Section 218(a) of the Revenue Act, so far as here material, provides:

> "Section 218(a). That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner *his* distributive share, whether distributed or not, of the net income of the partnership for the taxable year. * * *"

It is apparently the Government's present claim that there is something so inherently peculiar in a partnership interest that the record partner must be taxed upon all profits attributable to his record interest even though another may be the legal or equitable owner of that interest in whole or in part. That such is not the law has been repeatedly decided. In fact in *Hallahan v. Commissioner* (*supra*) the Board expressly repudiated this idea and *the Commissioner acquiesced in the decision* (VIII-2 C. B. 21). The decision of the Board in *Thomas v. Commissioner*

(supra) was to the same effect. And in *Wing v. Commissioner*, 17 B. T. A. 1028 (acquiesced in by the Commissioner, IX.—1 C. B. 59), the Board

> "Held, that the beneficial ownership of a one-sixth interest in the partnership property being in petitioner's wife, the one-sixth of the earnings of the partnership paid her individually by it represented income to her and not to petitioner."

Approving its position in the *Thomas* case *(supra)* and in many other cases cited in the opinion, the Board said, in the *Wing* case (at page 1030):

> "In this theory it has been overlooked that the identity of the party taxable upon income from a partnership interest is not determined merely by the name in which such interest is held but by the ownership of the corpus of the partnership interest.
>
> "As we view it, the income received by petitioner's wife upon her actual interest in the assets producing such income represented income to her whether she was in law a partner or whether the partnership agreement was under state law inoperative to create, as to her, a partnership liability. It is clear that even had petitioner's wife not been a party to the contract of partnership and the amount here in controversy been paid to petitioner as a portion of the distributive income of a partnership interest standing in his name alone, he would have received this sum merely as trustee for her, to whom it would be taxable."

In *Rucker v. Blair*, 32 Fed. (2d) 222, the Circuit Court of Appeals Ninth Circuit had for decision the question whether partnership profits were taxable *in toto* to the record partners even though the interest of one of the partners had been acquired with "community" funds. The Court said at page 224:

> "There is no *alchemy* in the term 'partnership' or in the relation it imports, and contributions of community funds to a joint or partnership enterprise are

not *ipso facto* converted into separate property. We are concerned with the status of property invested, not with the form in which it was held."

The Court accordingly held as syllabus (page 222):

"Where partnership, engaged in real estate business, after marriage of partner entered into logging and sawmill business on borrowed capital, and it did not appear that capital was procured on credit of or for benefit of property owned by partnership at time of partner's marriage, partner's share of profits resulting from logging enterprise was community income * * * and partner was required to make individual tax return *for only one half of his distributive share* leaving other half to be taxed as wife's property under Revenue Act of 1926."

The Circuit Court of Appeals Third Circuit in *Commissioner v. Barnes' Estate,* 30 Fed. (2d) 289, had for review the Board case reported in 7 B. T. A. 924. There had been informalities in the attempted transfers from husbands to wives of the husbands' interests in a partnership. The Board stated the question (p. 926):

"There remains, however, the question of law whether or not in view of the facts in the case there was a legal transfer of the interest in the partnership, or a gift of the profits, as and when such profits flowed from the partnership to the men, themselves, as partners."

Both Board and Court held for the taxpayers, the syllabus of the Court's decision reading:

"Gift to married women of interest of their husbands in partnership, made without notice to third partner, not registered and not followed by participation of assignees in management of company, held not void, as to Commissioner of Internal Revenue, under Uniform Partnership and Partnership Registration Act (Pa. St. 1920 section 16596 *et seq.*: sections 16639, 16640) where assignees received profits as partners

and paid income tax and assignment was made in good faith."

It is of interest to note that the Board, in deciding the instant case, cited and relied on *Hellman vs. United States* (R. 21) Court of Claims May 2, 1927 A. F. T. R. 6781. The Government likewise in its briefs below. But the decision of the Court of Claims in the *Hellman* case so relied upon by the Board and the Government was subsequently reversed on new trial (44 Fed. (2d) 83) and by a unanimous court. In that case partners had readjusted among themselves their respective participations in profits on a basis differing from that shown in the principal partnership agreement, the books and the tax returns. The Court said, in the course of a long opinion (pp. 89, 90, 91):

> "A new trial was allowed in this case * * * Defendant contends * * * that plaintiff was bound by the partnership return showing his distributive share. * * * Partners may adjust between themselves their distributive share in such proportion and in such manner as they may desire * * * Bookkeeping entries do not constitute income unless there is the right of ownership in the amount disclosed by such entries."

Undoubtedly the court below was entirely right when it said in its opinion (R. 26): "We do not see that Section 218(a) undertakes to fix any policy as to who is to be deemed to receive the income; it merely extends the definition of individual income so as to include partnership profits," whether distributed or not.

We submit that the Sixteenth Amendment was not intended to authorize the taxation of one person on income flowing from corpus *owned* by another. It should be observed that Section 218(a) relied upon by the Government did not impose any tax. Section 210 imposed the tax on individuals in the following words:

"Section 210 * * * there shall be levied * * * upon the net income *of* every individual a * * * tax at the following rates * * *."

The sole purpose of Section 218(a) appears to have been to provide that partnerships as such should pay no tax, but rather that the tax payable by reason of the partnership income, whether distributed or not, should be paid by the owners of the business as individuals. To tax the respondent upon income arising from corpus in which he had no beneficial interest would run counter to the definition of taxable income long since settled by this Court in *Eisner v. Macomber,* 252 U. S. 189, 207 as being "gain * * * derived, that is, received or drawn by the recipient for his separate use, benefit and disposal." The definition of income so announced by this Court has been frequently reiterated. (*U. S. v. Phellis,* 257 U. S. 156, 169; *Taft v. Bowers,* 278 U. S. 481; *Poe v. Seaborn,* 282 U. S. 101.) In the last cited case this Court said (p. 109):

> "The case requires us to construe sections 210(a)[1] and 211(a) of the Revenue Act of 1926 and apply them, as construed, to the interests of husband and wife in community property under the law of Washington. These sections lay a tax upon the net income of every individual. The act goes no farther, and furnishes no other standard or definition of what constitutes an individual's income. *The use of the word 'of' denotes ownership.* It would be a strained construction which, in the absence of further definition by Congress, should impute a broader significance to the phrase."

As said by the Circuit Court of Appeals (8th) in *Central Life Society v. Commissioner,* 51 Fed. (2d) 939, 941:

> "Tax laws are essentially practical * * * and the federal income tax laws are no exception. While, for

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[1] The language has been the same in each act since that of February 24, 1919, 40 Stat. at L. 1057, Chap. 18 U. S. C. title 26 Section 1262.

purposes of convenience and certainty in collection of such taxes, it is sometimes provided that those who collect income for others shall pay therefrom the taxes thereon, yet a cardinal purpose of the income tax laws is to tax the income to the person who has the right or beneficial interest therein, and not to throw the burden upon a mere collector or conduit through whom or which the income passes." (Numerous citations)

See also *Pugh v. United States,* 48 Fed. (2d) 600; *McKee v. Alexander,* 48 Fed. (2d) 838.

We submit, therefore, upon this phase of the case that Section 218(a) uses the word "partner" as synonymous with, and with no other force and effect than, "owner"; that the use of the word "his" in conjunction with the words "distributive share" in said section implies "ownership" just as the word "of" used in Section 210 was held by this Court in *Poe v. Seaborn (supra)* to "denote ownership"; that, as said in *Rucker v. Blair (supra)* "there is no alchemy in the term 'partnership' * * * we are concerned with the status of property invested, not with the form in which it was held." It follows that the income here in question was taxable only to the respondent's wife, she being the owner of the property or corpus which produced that income.

IV.

THE CONSTRUCTION OF SECTION 218(a) OF THE REVENUE ACTS OF 1918 AND 1921 URGED BY PETITIONER IS UNCONSTITUTIONAL.

To assess income tax liability against respondent predicated upon profits accruing upon a partnership interest owned by his wife merely because Section 218(a) provides that "the net income of each partner" includes "his distributive share, whether distributed or not, of the net income of the partnership" would clearly run counter to the Fifth Amendment. *O'Malley-Keyes v.*

Eaton, 24 Fed. (2d) 436, 438. This infirmity in the Petitioner's position was suggested by the dissenting opinions of five members of the Board of Tax Appeals in *Battleson v. Commissioner*, 22 B. T. A. 455, wherein it was said (p. 465):

> "The Sixteenth Amendment to the Constitution never was intended to tax and does not authorize the taxing of one person on another person's income; neither does the statute or any section thereof require that such be done. It has been urged that the peculiar wording of the statute, section 218(a) * * * requires that the distributive share of the profits of the partnership shall be taxed to the partners. * * * If the statute be construed so as to tax the husband with that income, when the wife is the owner of the income, a meaning is given to that statute that renders it clearly unconstitutional."

To the same effect is the vigorous dissenting opinion of Judge Manton in *Mitchel v. Bowers*, 15 Fed. (2d) 287, 289-292.

The view so expressed has been adopted and approved by this Court. In *Hoeper v. Tax Commission of Wisconsin*[1] No. 17 decided by this Court on November 30, 1931, this Court condemned the interpretation of a Wisconsin statute which would have taxed husband's and wife's income as a unit. The Court said:

> "Since, then, in law and in fact, the wife's income is in the fullest degree her separate property and in no sense that of her husband, the question presented is whether the State has power by an income tax law to measure his tax, not by his own income but, in part, by that of another."

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[1]Not yet officially reported.

After quoting with approval from *Knowlton v. Moore*, 178 U. S. 41, 77, the Court proceeded:

> "We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the Fourteenth Amendment. That which is not in fact the taxpayer's income can not be made such by calling it income."

If the Wisconsin statute under consideration by this Court in *Hoeper v. Tax Commission* (*supra*) violated the Fourteenth Amendment, then clearly Section 218(a) of the Revenue Acts would come within the ban of the Fifth Amendment were the construction claimed for it by the Petitioner herein to be adopted. In accordance with well established rules of construction the statute in question should be so construed as to be upheld if possible and any doubts in a taxing statute should be resolved in favor of the taxpayer. (*Reinecke v. Northern Trust Company*, 278 U. S. 339, 348, 349; *Gould v. Gould*, 245 U. S. 151, 153; *United States v. Merriam*, 263 U. S. 179, 187.) This result can be accomplished only by rejecting the construction claimed by the Petitioner herein for Section 218(a); thereby adhering to the conception and definition of income laid down by this Court in *Eisner v. Macomber* and other cases (*supra*).

V.

THE CASES RELIED UPON BY THE COMMISSIONER ARE BASED ON FACTS READILY DISTINGUISHABLE FROM THOSE OF THE INSTANT CASE: THEY APPLY TO ATTEMPTED ASSIGNMENTS OF FUTURE INCOME ONLY (AS DISTINGUISHED FROM AN ASSIGNMENT OF CORPUS AS HEREIN) OR TO REVOCABLE GRANTS (AS DISTINGUISHED FROM AN IRREVOCABLE ASSIGNMENT OF CORPUS AS FOUND HEREIN).

The petitioner, in his "summary of argument," discloses (brief p. 5) that he does not give proper force and effect to the findings of fact herein. For he argues:

> "Although it (Congress) treated partnership income in accordance with the doctrine of the common law, nothing in the statutes indicates that it intended to permit a further reduction by partial *assignments of what a partner might withdraw.* We submit that no agreement or assignment *in respect of the income* of the partnership can relieve a partner from a tax on all of his share of the partnership income * * *."

The authorities cited by counsel support the proposition so stated but they are utterly inapplicable to the instant case, wherein the respondent constituted his wife a half owner of his interest in the business itself. Let us analyze as briefly as possible the cases cited in petitioner's brief.

Mitchel v. Bowers, 15 Fed. (2d) 287, and *Harris v. Commissioner,* 39 Fed. (2d) 546, by the very language quoted at page 9 of petitioner's brief, are directed only against "partial assignments of so much as a partner may withdraw" i.e. against assignments of a share in profits rather than assignments of a share in the business itself. From the findings of fact in the *Mitchel* case (1 B. T. A. 144 and 15 Fed. (2d) pp. 288, 9) it clearly appears that the agreement between Mitchel and his wife contained no language purporting to convey to her a present interest in his interest in the partnership; on the contrary, the agreement

merely provided that the two should share the profits and losses *which he might receive* or to which he might be subjected; and, furthermore, the agreement contained the further important provision (absent in the instant case) that "the contract might be terminated at the option of either party 'at any time'." Judges Hand and Hough, constituting the majority of the court, seized upon this last provision (of revocability) as offering an escape from a difficult "dilemma," saying (p. 289):

> "As to these it may be plausibly argued that, since she could get nothing till the profits should '*come to*' him, and since he was to 'hold for and pay to' her all that he got, the profits must be his before they became hers. On the other hand, since they became hers, at least in equity (*Barnes v. Alexander*, 232 U. S. 117) as soon as he got them, it must be admitted that there was no instant of time after their distribution at which she was not entitled to them. Whatever might be the dialectical escape from the dilemma so raised, it seems to us that in any view the provision which allowed him at his pleasure to denounce the agreement put the absolute disposition of the profits always within his power. * * * It seems to us enough that the plaintiff retained the power to resume his title to the profits when he chose."

The strong dissenting opinion of Judge Manton (pp. 289-292) applies with even greater force to facts such as those herein. And furthermore the first paragraph of the syllabus of the case, which presumably reflects the views of the majority of the Court, indicates clearly that, upon facts comparable to those of the instant case, the decision would have been different:

> "1. In New York contract between husband and wife, entitling wife to *one-half of husband's profits* from partnership, and making wife liable for one-half of losses, assented to by other partners, did not make wife a partner, *since it did not give her any present interest, equitable or legal, in firm assets.*"

In *Harris v. Commissioner*, 39 Fed. (2d) 546, the same Court (Second Circuit) ruled upon the facts there presented, directly and almost solely on the authority of *Mitchel v. Bowers (supra)*. From the opinion (p. 547) it appears that Harris, as distinguished from the respondent herein, had no intent to convey to his wife any interest in the partnership as such, but only "to give a present share to his wife of his interest in the firm *profits.*" From the opinion (p. 547) we quote:

> "A partner who attempts to convey his interest in the profits of the firm, but not in its assets, can therefore do no more than agree that, as soon as he withdraws his share, the assignee shall be at once entitled to them; his assignment has no immediate effect * * *. All this we recognized in *Mitchel v. Bowers*, 15 Fed. (2d) 287, *though our decision primarily rested upon the power reserved to the husband to end the agreement*, which left the disposition of the profits always in his hands."

As indicated by the opinions as well as by the syllabi, *Mitchel v. Bowers* and *Harris v. Commissioner* have application to cases wherein the assignment is of future profits only; moreover, by the very statement of the Court, *Mitchel v. Bowers* was decided as it was "primarily" because of the right of revocation retained by the husband. And furthermore both cases must be read in the light of *Commissioner v. Field*, 42 Fed. (2d) 820, wherein it was recognized by the same court that the rule of *Mitchel v. Bowers* does not apply where a present corpus is assigned and the income in question flows from such assigned corpus. At page 822 the Court said:

> "The Supreme Court has declared in the broadest language that instruments intended to deflect income, subsequently falling due serially, from a husband to his wife are unavailing for tax purposes (*Lucas v. Earl*, 281 U. S. 111, 50 S. Ct. 241, 74 L. Ed. 731), thus tak-

ing a more comprehensive view of the statute than we found necessary in *Mitchel v. Bowers,* (C. C. A.) 15 F. (2d) 287, and *Harris v. Comm'r* (C. C. A.) 39 F. (2) 546. These were, however, all cases in which, though the instrument affected to convey an existing interest in property, there was none at the time which the law recognized. We do not understand that, where there are such, they may not be assigned like other property, or that, when they have been, the income is still taxable to the assignor. Hence the case turns upon whether, after the Illinois decree, Marshall had a present interest in the income of Henry's share assignable under the law of Illinois. If so, his deed as effectively divested him of the assigned interest, as though it had been land or a chattel; his wife became the beneficiary under the trust, and was the only person who could be taxed."

Lucas v. Earl, 281 U. S. 111, is unquestionably a case of outstanding significance. A correct understanding of its import and scope, however, must be predicated upon an analysis of its facts. The Government's claims, as stated by the Court (p. 113) pertained only to "the gain derived from labor", the contention being that such gain "can be salary only to the person who has performed the services": "The purpose of Congress cannot be defeated by an agreement—such as respondent made with his wife—that his earnings, including salaries and fees, *should be received* by him and his wife as joint tenants." That the controversy was so limited in scope is evidenced by the Court's reference to the statute upon which the decision is based (p. 114):

> "The Revenue Act of 1918 * * * Sections 210-212(a) 213(a) * * * imposes a tax upon the net income of every individual, including 'income derived from salaries, wages, or compensation for personal service' ",

making no reference whatever to those portions of the same sections which include in the definition gains from other sources, such as those springing from invested capital. The Court held the quoted portion of the law effective to "tax salaries to those who earned them" concluding with the words (p. 115):—

> "That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew."

Lucas v. Earl, by its very language, obviously lays down no rule as to tax incidence concerning income which flows from assigned corpus such as a partnership interest rather than from personal service. This Court indicated by its closing words in that case that the true test is: "On what tree did the fruit grow?" And so, in *Poe v. Seaborn,* 282 U. S. 101, 117, this Court defined the scope and effect of *Lucas v. Earl,* saying:

> "We held that assuming the validity of the contract under local law, it still remained true that the husband's professional fees, earned in years subsequent to the date of the contract, were his individual income, 'derived from salaries, wages, or compensation for personal services', under Sections 210, 211, 212(a) and 213 of the Revenue Act of 1918. The very assignment in that case was bottomed on the fact that the earnings would be the husband's property, else there would have been nothing on which it could operate."

Larsen v. Burnet, 50 F. (2d) 308 (Ct. App. D. C.) is relied upon by the petitioner. From the facts of that case as reported at 14 B. T. A. 163 it appears that the husband and wife entered into no agreement whatsoever; the husband, a member of a partnership, had utilized certain property which had been "community property" in another

state as his capital contribution to the firm, erroneously assuming (according to the court) that the wife would be entitled to one-half of the profits on the theory that she remained the equitable owner of a moiety of the property which he had invested. The Court ruled that the husband alone was a partner and that he alone was taxable on his share of the profits. Concerning this case it may be said, first, it seems in direct conflict with *Rucker v. Blair,* (C. C. A. 9th *infra*) which was approved and followed in *Poe v. Seaborn (infra),* and secondly, it must be read in conjunction with *Hall v. Burnet* decided by the same court (Ct. App. D. C.) *(infra).*

In citing and relying upon *Hill v. Commissioner,* 38 F. (2d) 165, *Pope v. Commissioner,* 39 F. (2d) 420, 424 and *Benedict v. Collector,* 38 F. (2d) 309, 313-314, the petitioner has, we submit, gone far afield. These cases involved substantially the same facts, not at all comparable to the issue which is involved in the case at bar. The *Hill* case is typical of the three. The facts were that one of the members of a partnership had died and the surviving partners, in accord with the terms of the partnership agreement, paid to the estate of the deceased partner over a period of years "*sums equal to* the full amount of the net profits which he would have received had he lived and the business had gone on." (168) The Court in each case properly held upon such facts that the surviving partners, constituting a new partnership from and after the death of the deceased partner, were chargeable with all of the net income of the new partnership without deduction of amounts paid to the estate of the deceased partner, which payments were for "the purchase of a capital asset" to-wit, the interest of the former partner. In the *Hill* case the Court said (at p. 168):

> "Those payments could be made out of any funds from which the petitioners chose to make them • • •

> the mere fact that the petitioners * * * elected to have it (the obligation) discharged out of the undistributed profits of the new firm did not create a charge upon those profits, nor diminish the petitioners' distributive shares therein. * * * The old firm was dissolved by S's death and his interest passed to the petitioners, subject to the payments they were to make under Article 14 * * * the payments * * * were made by the petitioners in the purchase of a capital asset."

Concerning the Board cases cited at p. 14 of petitioner's brief we may say: *Appeal of Mitchel*, 1 B. T. A. 143, 148, is the same case as *Mitchel v. Bowers* already discussed; *Appeal of Kneeland*, 1 B. T. A. 150, involved the same firm and the same facts as the *Mitchel* case; *Levering v. Commissioner*, 5 B. T. A. 616, involved an assignment of prospective profits only; so also *Knapp v. Commissioner*, 5 B. T. A. 762, *King v. Commissioner*, 10 B. T. A. 698, *Colbert v. Commissioner*, 12 B. T. A. 565 and *Staebler v. Commissioner*, 17 B. T. A. 1086. The *Luce* case, (18 B. T. A. 923) involved an attempt by a firm of lawyers to accomplish the identical thing which was denounced in *Lucas v. Earl (supra)*. The *Battleson* case, (22 B. T. A. 455) was so close upon its facts that strong dissenting opinions were written and concurred in by five members of the Board. The *Cohan* case, 11 B. T. A. 743 (a companion case to the *Harris* case which we have already discussed) went to the Circuit Court of Appeals (39 F. 2d, p. 540) which affirmed the Board in part, saying at p. 542:

> "There can be no doubt that he remained always free to stop his payments, and that her share depended on the endurance of his feelings toward her."

In other words the Court in the *Cohan* case found a situation exactly analogous to that in *Mitchel v. Bowers, supra*, so that the entire income from that source was taxable to Cohan. However, at page 543, the Court had for consideration other sources of income involving ownership

of the corpus by a transferee and with reference thereto modified the decision of the Board, holding that the tax incidence was upon the owner of the corpus from which the income flowed.

The petitioner challenges our reliance upon the Board cases of *Wing v. Commissioner*, 17 B. T. A. 1028, and *Dickinson v. Commissioner*, 23 B. T. A. 1211. But these cases are of the utmost significance because, under the law of Michigan therein involved, partnerships between husband and wife were forbidden. How can the petitioner reconcile his contention that only the record partners in a partnership (and not the equitable owners of the partnership shares) may be taxed on partnership income with the conclusion of the Board in the *Wing* case

> "That, the beneficial ownership of a one-sixth interest in the partnership property being in petitioner's wife [1] one-sixth of the earnings of the partnership represented income to her and not to petitioner"?

The entire contention of the government in the instant case was answered by the Board in the *Wing* case (at p. 1030) in these words:

> "In this theory it has been overlooked that the identity of the party taxable upon income from a partnership interest is not determined merely by the name in which such interest is held but by the ownership of the corpus of the partnership interest."

The petitioner next discusses "three analogous situations where one who is not the ultimate beneficial owner of income is taxed upon it." It should be observed that we contend for the taxability of the income to the respondent's wife rather than to the respondent not alone because of her beneficial ownership of the income as such, but also, and more fundamentally, because of her beneficial ownership of the corpus from which that income flowed.

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[1] Who under the law, could not be a partner.

However, considering the three categories suggested by petitioner's argument:—

(1) *Lucas v. Earl* is cited as typical of cases in the first category. In that case this Court said (at p. 115):

> "There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements * * * devised to prevent the salary when paid from vesting even for a second in the man who earned it."

But partners, in the absence of special agreement, do not receive salaries or compensation for services as such (*Parsons on Partnership*, 4th Ed., §155). What they receive is a share of the partnership profits and (we believe) the Commissioner has always treated income from a partnership in this manner, denying a partnership deductions for salaries of partners.

The form provided by the Commissioner of Internal Revenue for the return of partnership income contains an "instruction" reading as follows:

> "Enter as Item 13 all salaries and wages not included as a deduction in Line C of Item 2, *except compensation for partners, which shall not be claimed as a deduction in this item or elsewhere on the return.*"

The Respondent had no right to determine the deductions from gross income as suggested by the quotation at page 23 of Petitioner's brief; these deductions are definitely prescribed by law. Furthermore, as to the argument (petitioner's brief, pp. 18, 19) that amounts received by the Respondent must be treated as compensation for services, such suggestion does not conform with law. In G. C. M. 6582; CB Dec. 1929, page 200, the opinion of the General Counsel of the Bureau of Internal Revenue contains the following:

> "* * * *for income tax purposes so-called salaries of partners can not be recognized and are not permitted*

> *as deductible operating expenses of a partnership,* for the reason that partners receiving from partnership funds any sums of money necessarily receive such sums either out of the profits made by the partnership or, if there be no sufficient profit made, then out of the capital investment. Partners are working for themselves, and, in contemplation of law, a man may not constitute himself his own employee. (*Estate of S. U. Tilton et al. v. Commissioner,* 8 B. T. A., 914 (C. B. June 1928, p. 31)); appeal of *Harriet Taylor,* 2 B. T. A., 1159 (C. B. June 1928, p. 31.) Therefore, whatever is received by a partner in the form of or under the name of salary constitutes nothing more or less than a withdrawal from the partnership of anticipated profits, * * *."

See also *In re Karl Pauli,* 11 B. T. A. 784. The last mentioned case and also the cases cited in the General Counsel's Memorandum were acquiesced in by the Commissioner.

But, what is more fatal to the argument, every assignment of the kind condemned in *Lucas v. Earl* and kindred cases, is subject to the infirmity pointed out by this Court in *Poe v. Seaborn,* 282 U. S. 101 at p. 117, as follows:

> "The very assignment in that case was bottomed on the fact that the earnings would be the husband's property, else there would have been nothing on which it could operate."

In other words, these cases involve not the assignment of an existing income-producing corpus; but rather, and solely, the transfer of income arising in the future *qua* income, such income being the property of the assignor *when earned and received* and therefore taxable to him.

(2) The cases which come within the rule of *Bing v. Bowers* have already been fully discussed in this brief. They were all cases (as said in *Copland v. Commissioner, supra*) involving transfers "without consideration (of) a thing not in existence." And furthermore they were predicated upon mere assignments of future income. The dis-

tinction between such cases and the instant one is well stated in one of the cases which counsel now cite, *Bishop v. Commissioner,* No. 4517, decided by the Circuit Court of Appeals (7th) on December 9th, 1931, wherein the court said:

> "The distinction is very clearly recognized in *Hall v. Burnet, Commissioner,* No. 5173, decided by the Court of Appeals of the District of Columbia, November 16, 1931, but not yet published. In that case appellant, a life insurance agent, entered into a contract with his second wife, in which her rights in his property were defined for the protection of his children by a former marriage, in consideration of which she renounced her dower. Among other considerations moving from him he sold, assigned, and transferred to her an undivided interest in his *contract* with the insurance company. The court held that one-half of the subsequent renewal commissions should be taxed not to appellant but to the wife, as income accruing to her from the property right which appellant had assigned to her. The court said:
>
> "'* * * It is obvious that if what was here sought to be conveyed from the husband to the wife was salary, or personal earnings, the same would still be taxable to him though he never actually received it, but in the view we take of the case, what was assigned was neither income nor earnings, but property. It was not an assignment of future earnings but the transfer of a property right, and though this property right gave rise to future income, uncertain and contingent though it might be as to amount, that fact does not destroy the distinction.' "

See also

Copland v. Commissioner, C. C. A. 7th, *supra;*
Commissioner v. Field, C. C. A. 2nd, *supra;*
Kaufman v. Commissioner, 44 F. (2) 144, C. C. A. 3rd;
O'Malley-Keyes v. Collector, 24 F. (2) 436;

Young v. Collector, 28 F. (2) 789;
McKee v. Collector, 48 F. (2) 838.

(3) *Corliss v. Bowers*, 281 U. S. 376, which petitioner cites in his third category of cases wherein income beneficially belonging to one was taxed to another seems far afield. The court held:

> "The grantor of a *revocable* trust may constitutionally be assessed for income tax in respect of income from the trust fund, though such income was actually paid to the beneficiary, and so passed beyond his power to appropriate."

In the opinion (p. 378) the court said:

> "The acquisition by the wife of the income became complete only when the plaintiff failed to exercise the power that he reserved. *Saltonstall v. Saltonstall*, 276 U. S. 260; *Chase Nat. Bank v. United States*, 278 U. S. 327; *Reinecke v. Northern Trust Co.*, 278 U. S. 339.
>
> "Still speaking of taxation, if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is in the power of the first to appropriate, it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his own income, whether he sees fit to enjoy it or not."

Such words, applicable to the facts of *Corliss v. Bowers, Mitchel v. Bowers* and other cases cited by petitioner in this group, can have no application to the instant case wherein not only the income, but a half interest in the corpus which produced it as well, had irrevocably passed beyond the respondent's control.

We submit that the distinction between such cases and the instant case is analogous to that existing between cases (involving the estates tax) as *Chase National Bank v.*

United States, 278 U. S. 327, on the one hand, and *May v. Heiner*, 281 U. S. 238, *Burnet v. Northern Trust Company*, *Morsman v. Burnet*, and *McCormick v. Burnet*, 283 U. S. 782-785, on the other; the former involving retention of control by the grantor as in *Mitchel v. Bowers*, and the latter group involving complete and irrevocable passage of title *in praesenti* as in the case at bar. And so in *Reinecke v. Northern Trust Company*, 278 U. S. 339, this Court held one group of trusts to have been within the control of the settlor and therefore taxable, while holding another group of trusts non-taxable as having been completely irrevocable by the settlor from the date of their creation. The words used by this Court in *Chase National Bank v. United States*, 278 U. S. at page 336, apply to the facts of *Mitchel v. Bowers* and *Corliss v. Bowers* (*supra*) but have no application to the facts of the instant case:

> "Such an outstanding power reserved exclusively in a donor to recall a gift after it is made is a limitation on the gift which makes it incomplete as to the donor as well as to the donee * * *."

On the contrary the rule and language of *May v. Heiner* (*supra*, at p. 243) apply here in that the transfer from respondent to his wife of the income-producing corpus was complete and "beyond recall."

The so-called *Community Income Tax* cases decided by this Court November 24, 1930, are of outstanding significance because of the similarity between Community and Partnership title. *McKay on "Community Property,"* 2nd Edition, stresses this similarity (see pp. 113, 121, 762, 823). At p. 823 for example the learned author says:

> "Even though we may deny that express or implied contract is the actual basis of the legal community we are forced to admit that the wife's rights are the same in kind as though she had entered into a contract with her husband making the provisions of

law regulating the legal community the terms of this contract."

Wherever community property rights exist the analogy between community and partnership title is asserted. The points of distinction are technical and not material to our present deliberation (*Holyoke v. Jackson*, 3 Wash. T. 235; *Weil v. Jacobs*, 111 La. 357; *Gulf R. R. Co. v. Goldman*, 87 Tex. 567). In *Cervantes v. Cervantes*, 76 S. W. 790, 792, the Texas court said:

> "The laws of Texas create a partnership between the husband and wife, and declare that all property acquired during the existence of the partnership, as in other partnerships, shall be a common fund, except that derived from sources independent of and disconnected with the partnership."

Poe v. Seaborn, 282 U. S. 101, as decided by this Court, affirmed the same case as decided by the Circuit Court of Appeals (9th) which, in turn, had affirmed the District Court's decision reported in 32 Fed. (2d) 916. A reading of the last mentioned decision discloses that the District Court had based its conclusions squarely on *Rucker v. Blair*, 32 Fed. 2, p. 222. In that case the Circuit Court of Appeals (9th) had held that husband and wife might properly each return one-half of the income accruing upon an interest in a partnership which had been acquired with community funds. The court said (at p. 223):

> "The partnership return for 1918 exhibited a total distributive income of $95,699.27 divided equally between the two partners. Petitioner * * * made his individual tax return for one-half only of his distributive share, upon the assumption that it was community income, and that therefore the other half was returnable by his wife * * * (p. 224). The mere fact that the enterprise was carried on in the firm name is immaterial. There is no alchemy in the term 'partnership' or in the relation it imports, and contributions of community funds to a joint or partnership enterprise are not

ipso facto converted into separate property. We are concerned with *the status of property invested*, not with the form in which it was held."

In *Poe v. Seaborn* this Court (at p. 109) reasoned that the applicable sections of the several Revenue Acts levied a tax on the income "of" every individual; that the word "of" was intended to denote "ownership"; that under the laws of Washington "the wife has a vested property right in the community property equal with that of her husband" (p. 111); that the income attributable to her community interest is hers, not his, notwithstanding the broad powers of management and disposition which the law gave him. The court said (at p. 112):

> "The same policy dictates that third parties who deal with the husband respecting community property shall be assured that the wife shall not be permitted to nullify his transactions. The powers of *partners*, or of trustees of a spendthrift trust, furnish *apt analogies*. * * * (p. 113). The law's investiture of the husband with broad powers by no means negatives the wife's present interest as a co-owner."

In *Goodell v. Koch*, 282 U. S. 118, 121, this Court said:

> "The Arizona Supreme Court has *likened the community to a partnership. Forsythe v. Paschal*, 34 Ariz. 380, 271 Pac. 865. The husband as agent may not act in fraud of his wife's rights, and if he attempts to do so, she has a remedy in the courts. *Gristy v. Hudgens*, 23 Ariz. 339, 203 Pac. 569."

In *Hopkins v. Bacon*, 282 U. S. 122, 125, 126, the Court used these words:

> "'In view of our decision in No. 15 (*Poe v. Seaborn, supra*), the only matter to be examined here is whether under the community property system of Texas the wife has a mere expectancy, as she would under the law of California (Cf. *United States v. Robbins*, 269 U. S. 315) or, on the contrary, has a proprietary vested

interest in the community property such as makes her an owner of one-half of the community income.

"In view of what has been said in No. 15, it remains only to say that the interest of a wife in community property in Texas is properly characterized as a present vested interest, equal and equivalent to that of her husband, and that one-half of the community income is therefore income of the wife. She and her husband are entitled to make separate returns, each of one-half of such income."

In *Bender v. Pfaff*, 282 U. S. 127, the Court held to the same effect and, in the course of the opinion said (131, 132):—

"Repeatedly the statutes refer to the relation as a 'partnership or community' * * *. Inasmuch, therefore, as in Louisiana, the wife has a present vested interest in community property equal to that of her husband, we hold that the spouses are entitled to file separate returns, each treating one half of the community income as income 'of' each of them as an 'individual' as those words are used in Sections 210(a) and 211(a) of the Revenue Act of 1926."

Poe v. Seaborn (*supra*) and the other "Community Income Tax cases" decided by this Court November 24, 1930 were distinguished by this Court from *United States v. Robbins*, 269 U. S. 315, on the ground that under the California law involved in the *Robbins* case the wife had

"a mere expectancy and * * * the property rights of the husband during the life of the community were so complete that he was in fact the owner." (282 U. S. 116)

Subsequent to the decision in the *Robbins* case the California law was amended in such manner as to constitute the wife's community interest a vested estate rather than a mere expectancy and this Court in *United States v. Malcolm*, 282 U. S. 792, answered questions certified to it and arising under the amended California law in harmony

with its decisions in *Poe v. Seaborn* and the other community cases (*supra*).

The distinction so drawn by this Court between "a mere expectancy" and "a present vested interest" applies with like force to cases such as *Mitchel v. Bowers* on the one hand and the case at bar on the other; in the former the thing assigned was a "mere expectancy"; in the instant case it was "a present vested interest" in an existing corpus. The income involved herein was, in the words of *Lucas v. Earl* (*supra*) "fruit" which grew upon a "tree" of which the respondent's wife was the owner and the income was taxable to her, not to the respondent.

CONCLUSION.

We strongly suspect that this case would never have been presented to this Court were it not that the opinion of the court below contains a remote challenge to the validity of *Mitchel v. Bowers*. That challenge, if it be such, because of the disparity between the facts of that case and this, was quite unnecessary to the decision reached by the Circuit Court of Appeals.

> "It is judgments, decrees and rulings which an appellate court reviews and not opinions or reasons, and if the judgment, decree or ruling is correct, the court will not inquire into the reasons assigned * * * therefor * * *."
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> *Cyc. of Federal Procedure*, Vol. VI, page 566, and cases there cited.

We respectfully and earnestly submit that the decision of the court below responds to, and is required by, the facts as found and that, therefore, it should be affirmed.

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